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DEPARTMENT OF STATE REVENUE

LETTERS OF FINDINGS
NUMBERS 04-0303P AND 04-0372P

TAX ADMINISTRATION—NEGLIGENCE PENALTIES FOR THE PERIOD COVERING CALENDAR YEARS 1999-2001

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ISSUE

I. Tax Administration—Negligence Penalties

Authority: IC §§ 6-8.1-5-1(b), -10-2.1 (1998) (2004); 45 IAC § 15-11-2 (1996) (2001)

The taxpayers protest the parts of the proposed assessments that assess negligence penalties.

STATEMENT OF FACTS

The taxpayers are affiliated corporations with their commercial domiciles in the same state, one other than Indiana, and are engaged in retailing across the United States. During calendar years 1999-2001 (hereinafter "the audit period") the taxpayers had multiple outlets in Indiana.

The taxpayers paid the vast majority of the principal tax and accrued interest portions of the combined proposed assessments, but one of the taxpayers did timely protest a computational error of use tax and both protested the proposed imposition of negligence penalties. The Department corrected, and abated the part of the proposed assessments of the affected taxpayer attributable to the computational error, leaving the proposed negligence penalties as the only matters at issue in this protest.

DISCUSSION

The main point of the taxpayers' argument appears to be that the benefits that their new, expanded and remodeled stores provided to Indiana outweighed the unreported use tax the auditor assessed on the property used on those buildings, thereby justifying abatement of the negligence penalties. If the Department understands the taxpayers correctly, these benefits included improvements to Indiana real property, employment opportunities for Indiana citizens

and additional consequential state and local tax revenues. The taxpayers also represent, but have submitted no proof, that since the audit they have put more internal accounting controls in place in order to strive for more accurate reporting of their sales and use tax liabilities.

IC § 6-8.1-10-2.1 (1998) (current version at *id.* (2004)) is the statute that authorizes the Department to impose a penalty for any negligence of a taxpayer in failing to comply with the tax laws that the Department administers. These taxes are listed in IC § 6-8.1-1-1 and include the gross retail and use tax. IC § 6-8.1-10-2.1(a)(3) states that "(a) [i]f a person:… (3) [i]ncurs, upon examination by the department, a deficiency that is due to *negligence*;… the person is subject to a penalty." *Id.* The amount is set by IC § 6-8.1-10-2.1(b)(4), which states that "(b) [e]xcept as provided in subsection (g) [,] [not in issue here], the penalty described in subsection (a) is ten percent (10%) of:… (4) the amount of deficiency as finally determined by the department[.]" *Id.* However, IC § 6-8.1-10-2.1(d) states that "[i]f a person subject to the penalty imposed under this section can show that the failure to…pay the deficiency determined by the department was due to *reasonable cause* and not due to willful neglect, the department shall waive the penalty." *Id* (emphasis added).

Under IC § 6-8.1-5-1(b) (1998) (current version at *id.* (2004)) and 45 IAC § 15-5-3(b)(8) (1996) (2001), the person against whom a proposed assessment is made has the burden of proving that it is wrong. That burden applies to abatement of penalty assessments, as well as substantive tax assessments. *"A person who wishes to avoid the penalty imposed under [IC § 6-8.1-10-2.1(a) and (b)] must make an affirmative showing of all facts alleged as a reasonable cause* for the person's failure to file the return, pay the amount of tax shown on the person's return, pay the deficiency, or timely remit tax held in trust[.]" IC § 6-8.1-10-2.1(e) (emphasis added). The burden of proof is not on the Department to show negligence, willful or otherwise, by a taxpayer.

Title 45 IAC § 15-11-2(b) states:

> (b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's *carelessness,* thoughtlessness, disregard or inattention *to duties placed upon the taxpayer by the Indiana Code or department regulations.* Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

Id (emphases added). The next subsection of the regulation sets out the standard of care a taxpayer must prove pursuant to IC § 6-8.1-10-2.1(e) to establish reasonable cause for failing to meet its tax compliance duties to the Department. Subsection (c) of 45 IAC § 15-11-2 reads in relevant part as follows:

> (c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 [sic; should read IC 6-8.1-10-2, repealed and re-enacted in 1991 as IC 6-8.1-10-2.1] if the taxpayer affirmatively establishes that the failure to…pay a deficiency was due to reasonable cause and not due to negligence. *In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.*….
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> …
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> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Id (emphasis added).

The Department did not include in 45 IAC § 15-11-2(b) or (c) the kind of revenue cost-benefit analysis in which the taxpayers would now have the Department engage. The reason for the Department's omitting such a test from the regulation becomes obvious upon reflection: Title 45 IAC § 15-11-2(b) defines "negligence" "as the failure to use such reasonable care,…as would be expected of an ordinary reasonable taxpayer[ ]…[in performing] duties placed upon the taxpayer by the Indiana Code or department regulations." *Id.* Conversely, 45 IAC § 15-11-2(c) states that a taxpayer must submit proof that it "exercised ordinary business care and prudence" in order to establish "reasonable cause" to abate a negligence penalty. *Id*. Thus, evidence that a taxpayer engaged in business/es in Indiana that directly or indirectly created more state and local tax revenues than the sum of its proposed substantive tax assessment/s is quite simply irrelevant to proving the absence of "negligence" and the existence of "reasonable cause" as 45 IAC § 15-11-2(b) and (c) respectively define these terms. Specifically, such evidence has no tendency to make it more, or less, probable that the taxpayer in question "exercised [the] ordinary business care" in performing any such statutory or regulatory duty that is needed to establish "reasonable cause." 45 IAC § 15-11-2(c).

Even if the taxpayers had submitted any evidence of their alleged creation of additional internal accounting controls since the audit, any such evidence also would have been irrelevant to whether the taxpayers were negligent during the audit period in failing, or had reasonable cause for their failures, to report use tax on their capital assets and fixed assets. Their implementation of such safeguards, if true, would have occurred well after the audit period ended. Thus as a matter of causation (or, more accurately, lack of causation), their alleged installation of those procedures could not have had any mitigating effect on the taxpayers' negligence during that period. In addition to the absence of evidence and lack of relevance of the alleged controls, the Department also notes that in any original tax appeal, they would not be able to introduce evidence of the such controls as proof that the taxpayers were negligent during the audit period. *See* IND. R. EVID. 407 (making evidence of subsequent remedial measures inadmissible to prove negligence or culpable conduct in connection with an event). It is therefore only fair that, at the administrative level, the Department should decline to consider the taxpayers' request for relief from the proposed negligence penalties for such after-the-fact reasons.

The present taxpayers have not submitted any evidence in support of their protests of the proposed negligence penalties that would establish the existence of "reasonable cause" under IC § 6-8.1-10-2.1(d) and 45 IAC § 15-11-2(c). The taxpayers have therefore failed to sustain their burden of proof under IC § 6-8.1-5-1(b) that the proposed negligence penalty assessments are wrong, i.e. that they were not negligent in, and had reasonable cause for, failing to remit use tax on its capital assets and fixed assets.

FINDING

The taxpayers' protests are denied.

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